



The Consumer Council

Elizabeth House
116 Holywood Road
Belfast
BT4 1NY

Graham Craig
Gas Branch
Utility Regulator
Queens House
14 Queens House
Belfast
BT1 6ER
E-mail: graham.craig@uregni.gov.uk

5 July 2012

Dear Graham

Re: CCNI response to NIAUR's Discussion Paper on Gas Network Extensions in Northern Ireland

The Consumer Council welcomes the opportunity to respond to this discussion paper.

The Consumer Council is an independent consumer organisation, working to bring about change to benefit Northern Ireland (NI) consumers. Our aim is to make the consumer voice heard and make it count. We have a statutory remit to *promote and safeguard the interests* of consumers in NI and we have

specific functions in relation to energy, water, transport and food (the Consumer Council and the Food Standards Agency (FSA) have a memorandum of understanding and the Council's strategic focus on food is primarily in relation to food prices and customer experience). These include considering consumer complaints and enquiries, carrying out research and educating and informing consumers.

The Consumer Council is also a designated body for the purposes of supercomplaints, which means that we can refer any consumer affairs goods and services issue to the Office of Fair Trading, where we feel that the market may be harming consumers' best interests.

In taking forward our broad statutory remit we are informed by and representative of consumers in NI. We work to bring about change to benefit consumers by making their voice heard and making it count. To represent consumers in the best way we can, we listen to them and produce robust evidence to put their priorities at the heart of all we do.

Background

The Consumer Council (CCNI) recognises the real benefits that gas currently provides to consumers in terms of costs, energy efficiency, payment methods and ease of use. With the high level of fuel poverty and significant increases in the price of home heating oil, the decision on whether to extend the natural gas network is an important one for consumers.

An extension of the network could provide benefits to consumers; however, the significant level of investment required is likely to impose costs that will be felt by consumers for many years to come.

CCNI is of the opinion that the plan to extend the gas network should be balanced against the need to maximise the number of connections in the

existing licence areas. This second option would provide a more economical solution to tackling fuel poverty and reducing carbon emissions than DETI's proposed gas network extension. For example, the maximum estimated uptake of natural gas in the gas extension area is 31,387 connections¹, whereas and estimated 252,000 domestic households remain off grid in the existing two licence areas².

The Consumer Council believes that policy makers and those with advisory roles must ensure that the consumer is placed at the heart of Northern Ireland's energy strategy.

Key strategic issues

In securing Northern Ireland's future energy needs, we believe that the Government, and the Regulator in its role to advise on and implement energy policy in Northern Ireland, will need to balance:

- Affordability
- Security of Supply; and
- Sustainability

In relation to this discussion paper by the Regulator, CCNI believes that there are a number of strategic issues that could have a significant impact on the decision to extend the network and the preferred regulatory or business model. These include, amongst others, the potential for extracting shale gas in Northern Ireland, the future price differential of gas compared to other heating sources and the requirements to meet renewable energy generation targets. We have commented on each of these issues in this section of our response.

¹ Source: Utility Regulator Discussion Paper on Gas Network Extensions in Northern Ireland, May 2012

² Source: Utility Regulator

CCNI is concerned that despite not making any reference to these key issues in DETI's consultation on the gas extension from June 2011 and this discussion paper by the Regulator, both parties are pushing ahead with the plans to extend the gas network, pending approval by the NI Executive. As a result CCNI believes strongly that unless the Regulator has clear evidence from DETI demonstrating that these issues have been factored in their appraisal of this project, a thorough examination of the issues outlined below is required before deciding on the extension of the gas network and also the licence award process to ensure the interests of consumers, present and future, are safeguarded.

Also, given the budget constraints that are likely to exist for the duration of the gas extension project, DETI must demonstrate that the gas network extension fits into a coherent and long term strategic energy plan that maximises available resources. This must take into account the key priorities and actions included in the Strategic Energy Framework from September 2010, in particular in relation to the renewable heat targets, gas storage and others.

- Extraction of shale gas deposits within the projected gas extension area**

DETI has granted to date four licences to "search and bore and get petroleum"³, including natural gas reserves. Explorations have already been carried out at the Lough Allen Basin (North) in Fermanagh, leading to estimations that the existing deposits on the site could provide up to 50 years worth of gas supply.

It is therefore argued that fracking could make a significant contribution to securing Northern Ireland's energy supply for the foreseeable future. Given that some of the potential shale gas deposits are located within or close to the planned gas network extension, it could also affect entirely the parameters of

³ http://www.detini.gov.uk/deti-energy-index/minerals-and-petroleum/petroleum_licensing_2.htm

the gas network extension project, particularly in relation to funding, costs and the design of the network.

CCNI appreciates the uncertainty and opposition that exists to the developing of the fracking industry in Northern Ireland. This is based largely on concerns about the impact on the environment and human health that fracking can have. However, given the economic benefits that fracking can provide, we cannot discard that licences to extract natural gas are granted within the timescales of DETI's proposed extension of the gas network.

One of the Regulator's proposed guiding principles is the protection of "the interests of gas consumers (present and future)". Therefore the Regulator and DETI must examine in detail the potential implications that the extraction of shale gas, particularly in Fermanagh, could have on the gas network extension project, including the design of the licence award process.

- **Extension of gas network in ROI**

The level of investment required to complete the extension of the gas network is significant, regardless of the chosen business model. Any increase in the amount that consumers will need to pay for their gas must be seen in the context of the rising costs for energy that consumers will likely have to pay in the future.

CCNI believes that it is imperative that those involved in the design and implementation of the gas network project explore in detail alternative funding options that reduce the final cost to consumers. One such option is the development of joint funding arrangements with the Republic of Ireland Government who have a shared interest in developing a gas network in the north-west⁴.

⁴ <http://www.wdc.ie/publications/reports-and-papers/reports-2011/>

We ask the Regulator, and DETI as the energy policy maker, to engage with their counterparts in the Republic of Ireland at the earliest possible opportunity to discuss existing plans and the feasibility of cooperation that results in reduced overall cost of the project through joint funding, planning and use of resources.

- **Future cost of gas against competing fuels – renewable heating**

CCNI recognises the potential cost (and environmental) benefit of natural gas over other fossils, such as home heating oil. However, we would like to highlight Malcolm Wick MP's independent report, "Energy Security – A National Challenge in a Changing World"⁵. The report discusses that in the future fossil fuels, including natural gas, are going to become even more prone to high or volatile prices, and possibly disruptions in supply.

We believe that it is essential that energy policy must be coherent and different strands must dovetail. Renewable Heat and natural gas both offer benefits to consumers and each can contribute to DETI's Strategic Energy Framework. However, the development of each should be planned to deliver mutual success for each project and to provide the most efficient outcome for Northern Ireland consumers. The worst case scenario would see an extended gas network that becomes a stranded asset that is economically unsustainable for either consumers or investors.

In addition many rural areas of Northern Ireland are unlikely to ever be connected to the gas network. It is these rural areas that may benefit the most from a Renewable Heat incentive.

⁵ www.decc.gov.uk

Questions for respondents

CCNI believes that the eradication of fuel poverty in Northern Ireland is a key priority in determining the regulatory and business model and geographical scope of the project.

We have outlined below our responses to the questions that are relevant to consumers. However, we would like to see the arguments for and against each of the options put forward by the Regulator laid out clearly and in detail in the formal consultation that will follow this discussion paper if the NI Executive approves the gas network extension. These should include supporting evidence and figures that inform any CCNI future response about this project.

Q2. We would welcome views on whether the principles above are appropriate

CCNI supports the principles outlined by the Regulator to guide its approach to the network extension. However, we believe that the eradication of fuel poverty should be a key priority of any decision regarding the extension of the gas network or the licence award process. Therefore we ask the Regulator to make explicit references within principles four and five, “promote the development of the gas industry” and “protect the interest of gas consumers” to “vulnerable customers” and “those in fuel poverty”.

Q3. We welcome views on how potential deviations between tendered and actual cost levels should be taken into account as part of the distribution award of licence process.

CCNI recognises that deviations between tendered and actual cost levels pose a significant risk to consumers. Therefore we call on the Regulator to introduce mechanisms within the licence award process minimising the

potential for deviations by tenderers, ensuring the transparency of the costs and limiting the risk to consumers. We would require additional information about the various options proposed by the Regulator before commenting further.

Q4. We welcome views on the approach above to dealing with the construction risks associated with transmission. We would also welcome views on which risk should be shouldered by consumers and which are best placed to manage.

CCNI notes the Regulator's concerns about the greater risks associated with the construction of the transmission network. We believe that the licence award process should require tenderers to demonstrate how they plan to reduce the overall risk of the project so that consumers can benefit from reduced project costs.

We believe that since consumers have no control whatsoever over the risks associated with the construction of the pipeline, the Regulator should introduce safeguards limiting the amount of risk placed on them such as setting the proposed capital allowances based on tendered construction rates. We will comment further on this point once the Regulator provides more detailed information.

Q5. The Utility Regulator seeks respondent's views on how best the licence process could be designed to balance our statutory duties with reference to different business models.

CCNI believes that natural gas provides a number of significant benefits to consumers in Northern Ireland. Therefore we are of the opinion that the overall aim of the gas network extension project must be to connect as many domestic households as possible, particularly those in fuel poverty. This is in

addition to connecting as many businesses and public sector buildings as possible.

We would expect the process to be competitive and transparent to give consumers confidence that this is the case by for example, ensuring government procurement rules are followed.

Q6. We would welcome any thoughts respondents may have on connections incentives and their importance as a mechanism to distinguish between the bids of potential licensees.

One of the main barriers preventing for example heating oil users from converting to natural gas is the investment required. According to the Energy Savings Trust, typically the upfront cost to domestic households of installing a condensing gas boiler is around £2,500⁶.

The uptake figures in the Greater Belfast and Ten Towns licence areas are 46 per cent and 31 per cent despite incentives available of between £200 and £400 as well as affordable credit being offered. Those uptake figures would demonstrate that in order to maximise the number of domestic customers that convert to gas it will be necessary to provide a financial incentive, particularly targeting fuel poor households.

CCNI believes that the overall cost of extending the natural gas network would need to take into account the cost of providing this financial support to ensure the key priority of eradicating fuel poverty is met.

Q7. We would welcome any thoughts respondents may have on user commitment.

⁶ Energy Savings Trust

If the gas network is extended, it is essential that the I&C and the public sector estate must be fully committed to converting to gas. The NI Executive must use its influence and power, particularly within the public sector, to ensure any commitment given materialises in high uptake from those sectors. The Feasibility Study from March 2010 of the gas extension shows that by guaranteeing the demand for a large base load volume of gas, the case for extending the network is enhanced. The I&C and public sectors will significantly contribute to the base load required for the project to be financially feasible. Also, the substantial volumes of gas that the I&C and public sectors would burn would help reduce the transmission and distribution charges for all gas consumers.

Q8. We would welcome views on the appropriateness of supply exclusivity.

CCNI recognises that competition of supply has the potential to deliver significant benefits to consumers, for example lower prices and better customer service. It's also worth noting according to DETI's timeframe, by the time of the first connections in the extended gas network, full competition of supply would exist in the Greater Belfast and Ten Towns licence areas.

CCNI supports in principle the introduction of competition into Northern Ireland energy markets where it can be clearly shown that it will provide tangible benefits for consumers. However, we need to see the economic case for and against in detail within the formal consultation.

Q9. We would welcome views on what alternative forms of network development may be considered to extend the gas network and how they could be factored into the design of the licence award process.

CCNI recognises the complexities and challenges that the gas network extension poses. The Regulator acknowledges those in the workshop held on

23 May 2012. Two of the main issues are the projected cost involved and future proofing the network, particularly given the requirements on renewable generation and the uncertainty about the future price differential of gas versus other sources of heating.

Therefore we would support any alternative forms of network development that help reduce the level of investment required and the implementation of future environmental technologies in the future.

We have mentioned earlier in our response that the extraction of shale gas in the west of Northern Ireland and the development by the Republic of Ireland Government of the gas network in the north-west are two potential developments that could have significant implications for this project. Therefore CCNI calls on the NI Executive and the Regulator to consider those factors thoroughly when deciding on the proposals to extend the gas network and designing the licence award process.

Q10. How fixed or flexible should the Regulator be in prescribing those factors that potential licenses should compete on?

CCNI supports the adoption of a selection process that maximises the benefits to consumers while it also encourages submission of applications to ensure the process is competitive. We believe that while a degree of flexibility must exist, the Regulator should impose certain restrictions, for example publishing a list of the accepted regulatory models that will ensure the delivery of quantifiable benefits to consumers.

Q11. We would be interested in views on the factors that companies might compete on for transmission and distribution and what other assessment criteria may be necessary.

Given the level of complexity and risk involved in this project, CCNI would not oppose the introduction of a pre-qualification stage requiring tenderers to demonstrate having the financial resources and technical skills to build and operate a natural gas network safely and efficiently. This prerequisite would remove uncertainty and improve the stability of the project, thus potentially reducing the risk involved.

With regards to the Capital and Operational Expenditure, it is imperative that despite all the complexities, this project is delivered at the lowest cost possible for consumers. Therefore cost efficiency must be a key criteria in selecting the preferred bidder. In addition, any proposed cost structure must be transparent and easily comparable to ensure consumer confidence in the project.

We have previously stated that the eradication of fuel poverty must be a key priority of any plans to extend the gas network extension. Therefore we propose that tenderers are assessed also on their projected targets for number of connections.

Similarly, the balance of risk must not fall inequitably with the consumers. CCNI would prefer to see a cost reflective Regulatory Rate of Return, combined with efficiency and service output incentive models. This would ensure that the project remains attractive to investors, while consumers benefit from the higher efficiencies that the company is incentivised to achieve.

Q12. We would be interested in stakeholder views on whether the award of licence process for transmission and distribution should occur in parallel or sequentially.

The Regulator's discussion paper outlines a number of advantages for the implementation of both parallel or sequential award of licence processes for

the transmission and distribution elements of this project. We ask that the Regulator provides more details about the pros and cons of each option in the formal consultation so that CCNI can clearly asses which option provides the most benefits for consumers. Furthermore, we ask the Regulator to take into consideration the key strategic issues that we outlined earlier in our response as we believe they have the potential to have a significant impact on this project.

Q13. We would be interested in stakeholder views on whether there should be a single distribution licence covering the entire area of the network extension.

CCNI believes that it is unsatisfactory for customers to be paying a different price for their gas on a depending on their licence area within the small regional area of Northern Ireland. If multiple licence areas are chosen this provides the potential for further customer confusion. Furthermore, a single, larger licence area is more likely to be attractive to competing suppliers to enter the market in the future.

Conclusion

CCNI appreciates that the purpose of this Discussion Paper by the Regulator is to inform preliminary the design of the licence award process for the extension of the gas network. While we note the Regulator's indication that their role is restricted to implement the energy policy formulated by DETI, we are concerned with the urgency shown to put in place the licence award process.

It is our view that DETI and the Regulator would appear not to have examined in details to date to key strategic issues that could have a significant impact on the feasibility of the project and also the funding, costs and design of the network. It is imperative that DETI and the Regulator, in its advisory role, give

full consideration to these issues before any decision about this project is reached to ensure the interests of consumers, present and future, are safeguarded. We would welcome the opportunity of discussing these issues in more detail.

With regards to the proposed licence award process, we will comment further when a formal consultation is issued if the NI Executive approves the extension of the gas network. However, the consultation must outline clearly the pros and cons of each of the proposed options, including supporting evidence and figures to inform our future response.

We hope you will find our comments useful and look forward to discussing these issues in more detail at a future date. You can contact a member of CCNI energy policy team on 028 9067 2488 to arrange a meeting or to request additional information.

Yours sincerely,

MARIAN CREE

Head of Policy (energy)